



SBA West Virginia District Office
320 West Pike Street, Suite 330
Clarksburg, WV 26301
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Calculating Global Cash Flow

February 16, 2016

Level: Advanced

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PRESENTERS:

GARY E. GRIFFIN – CAPITAL GROWTH SOLUTIONS

RAY CHIAMULERA – RADAR LENDER SERVICES

Acknowledgment

We would like to thank Gary Griffin and Ray Chiamulera for their time on this webinar and offering information regarding their experience in lending and working on SBA loans from their perspective.



Presentation Content

1. SOP Requirements
2. Reading a Tax Return
3. Reading a Credit Report
4. Basic Cash Flow
5. Global Cash Flow
6. Working Capital Adequacy

Cash Flow – Why is it important to YOU!

The SBA SOP 50 10 5(h) states:

SBA has authorized PLP Lenders to make the credit decision without prior SBA review. The lender must perform a thorough and complete credit analysis of the applicant, establish that the loan is of such sound value as to reasonably assure repayment and document its analysis in the loan file. See HORROR STORIES (just kidding, sort of!).

3 Scenarios per SOP

1. \$350,000 or Less
2. Greater than \$350,000
3. SBA Express Products

SBA Underwriting Requirements

The SBA SOP 50 10 5(h) also states:

Lenders must analyze each application in a commercially reasonable manner, consistent with prudent lending standards. The cash flow of the Small Business Applicant is the primary source of repayment, not the liquidation of collateral. Thus, if the lender's financial analysis demonstrates that the Small Business Applicant lacks reasonable assurance of repayment in a timely manner from the cash flow of the business, the loan request must be declined, regardless of the collateral available or outside sources of cash.

Under \$350,000

SIMPLE: Credit Score!!!

Caution: These loans MUST be treated as similarly sized convention commercial loans. If you underwrite to a certain criteria, you should underwrite these loans to that same criteria. SBA has indicated that loans that “score” in there model will receive less scrutiny than larger loans however (due to performance data).

Over \$350,000

That's what this is all about. SBA has a 1.15X rule, and used to have a 1.0 DSC rule for global, which disappeared in the "h" edition. For non-PLP lenders, you still have the benefit of a financial review at the Processing Center. This session will show you what the SBA LO will be evaluating. For ALL PLP lenders, beware. Follow our presentation closely, and DOCUMENT EVERY DECISION AND ASSUMPTION CLOSELY!

SBA Express

Treat the same as similarly sized conventional commercial loans (that's what the SOP says). Our recommendation is that on loans which are "projection" deals, treat the same as any PLP request. In other words, DOCUMENT your assumptions in DETAIL, and have support. After 18 months, you should be clear. It's not the SBA! OIG is the live wire in the room.

Definitions

OCF-Operating Cash Flow = EBITDA

DS-Debt Service = P+I of all business debt including the subject loan

DSCR- Debt Service Coverage Ratio= OCF/DS

Unfunded Capital Expenditures-the amount of all Capital Expenditures less any Capital Expenditures funded by Permitted Debt, Subordinated Debt or by the proceeds of any equity issue of the Borrower

OCF Additions/Subtractions

Your loan analysis must document additions and subtractions to cash flow such as the following:

1. Unfunded capital expenditures;
2. Non-recurring income;
3. Expenses and distributions;
4. Distributions for S-Corp taxes;
5. Rent payments;
6. Owner's Draw

All additions and subtractions must be evident in the financial data.

Capital Expenditures

1. Obtain the financial statements of the target company as of the end of the year for the past two years.
2. Subtract the net amount of fixed assets listed on the financial statements for the preceding year from the net amount of fixed assets listed for the year just ended. The result is the net change in fixed assets. However, it must be adjusted further with these additional steps:
 - a. Strip out of the calculation all intangible assets. You are only interested in the expenditures for tangible assets - most intangible assets were obtained through acquisitions, not through a capital expenditure program.
 - b. Strip out all assets obtained through acquisitions during the reporting period. This information should be listed in the notes accompanying the financial statements.
3. Subtract the total amount of accumulated depreciation listed on the financial statements for the preceding year from the total amount of accumulated depreciation listed for the year just ended. The result is the total amount of depreciation for the year just ended. An alternative source is the depreciation expense listed in the income statement for the year just ended. This figure should not include any amortization, nor any depreciation associated with acquired assets.
4. Add the total depreciation for the year to the change in the net amount of fixed assets. This is the total amount that the company spent on capital expenditures during the measurement period.

Non-Recurring Income

Potential Non-Recurring Income items include

Capital Gains

Legal Settlements

Insurance Settlements

Discontinued products/services

Distributions

Distributions are balance sheet adjustments and are not deducted as part of EBITDA

1. Determine how you are going to treat distributions and explain.
2. Excessive distributions with no like increase in personal assets or decrease in personal expenses

Maximize the Maturity

The Lender may use blended maturity or a maturity up to the maximum for the asset class comprising the largest percentage of the use of proceeds.

Benefits to Maximizing the Maturity

Improved debt service ability of the borrower

Gives the borrower more flexibility in managing its cash by financing more of the project

Global Debt Service

SBA SOP 50 10 5(h) states

Lenders must demonstrate the Small Business Applicant's ability to repay the loan from the cash flow of the business by documenting the following:

- The small business applicant's debt service coverage ratio must be equal to or greater than 1.15 on a historical and/or projected cash flow basis
- Except for loans under \$50,000, the Small Business Applicant's global cash flow coverage ratio exceeds 1:1 on a projected basis.

Global Debt Service

The SBA does not formally dictate the definition of Global Cash Flow, but it should include

Income/loss from affiliated companies,

Adjustments for inter-company transactions,

Personal financial needs of all guarantors,

Analysis of both cash based and accrual based statements where appropriate,

An explanation of any excluded debt (debt to be placed on standby, debt being paid off within a short time period, etc.).

Basic Debt Service Calculation

Debt Service Calculation w/Standard Addbacks

Revenue	\$1,484,673
Net Income	\$130,307
+ Rent	\$180,000
+ Interest	\$23,354
+ Depreciation/Amortization	\$23,354
+ Officer's Salary	\$130,000
- Officer Draw/New Owner Comp.	(\$108,000)
Cash Available to Service Debt	\$379,015
Projected Debt Service	\$200,000
Excess Cash Flow	\$179,015
Debt Service Coverage Ratio	1.90

Where Is It?

Personal Credit Report – does not include contingent

Personal Financial Statement

Form 1120 – Schedule M-1 & other deductions (Statements)

Form 1065 – Personal Taxes

Form 1040 – K-1, Schedule E (affiliates), real estate taxes and income taxes

Global Debt Service

Global Debt Service Sample

	2010	2011	2012	2013
Personal Cash Flow-Guarantor #1	\$70,873	\$85,152	\$81,506	\$81,506
Personal Cash Flow-Guarantor #2	\$129,756	\$126,141	\$171,274	\$171,274
Personal Cash Flow-Guarantor #3	\$62,688	\$5,137	\$24,294	\$24,294
EBITDA - OC	\$642,715	\$711,714	\$648,611	\$583,259
EBITDA - Affiliate #1	\$193,652	\$219,849	\$347,329	\$343,817
EBITDA - Affiliate #2	\$118,028	-\$75,196	\$283,693	\$214,009
Total Existing Cash Flow	\$1,217,712	\$1,072,797	\$1,556,707	\$1,418,159
Personal Debt-Guarantor #1	\$304,392	\$304,392	\$304,392	\$304,392
Personal Debt-Guarantor #2	\$19,920	\$19,920	\$19,920	\$19,920
Personal Debt-Guarantor #3	\$44,148	\$44,148	\$44,148	\$44,148
Existing Debt-OC	\$89,124	\$89,124	\$89,124	\$89,124
Existing Debt-Affiliate #1	\$178,920	\$178,920	\$178,920	\$178,920
Existing Debt-Affiliate #2	\$188,580	\$188,580	\$188,580	\$188,580
Proposed New Loan	\$203,364	\$203,364	\$203,364	\$203,364
Total Debt	\$1,028,448	\$1,028,448	\$1,028,448	\$1,028,448
Global Debt Service Coverage	1.18	1.04	1.51	1.38

Working Capital Needs

One of the leading reasons for business failure is adequacy of working capital. Your analysis needs to show that working capital is sufficient to support the business and sales growth.

Adequacy of Working Capital

This is a key component to the credit decision and one that is scrutinized in repurchases and audits. The lender must determine and justify the adequacy of working capital in a loan request. Simply stating that the business is a cash business or that the principals have additional cash if needed is not sufficient. What is the cash cycle of the business? How much time will pro forma working capital support in the business? How much availability is there in other LOCs?

These questions must be answered and the amount of working capital in the loan supported.

Working Capital Analysis

Steps to determining adequacy of working capital for non-cash businesses.

1. Determine the cash expenses of the business
2. Calculate the cash needs of the business
3. Determine what sources will support the cash needs

Thank You!

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